

Message Text

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ACTION EB-07

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R 080830Z JAN 76

FM AMEMBASSY MANILA

TO SECSTATE WASHDC 969

INFO AMCONSUL HONG KONG

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E.O. 11652: N/A

TAGS: EFIN, RP

SUBJECT: NEW REGULATIONS AFFECT MONEY AND CAPITAL MARKETS

SUMMARY: AS PART OF AN EFFORT TO INCREASE MEDIUM AND LONG-TERM FUNDS AVAILABLE FOR INVESTMENT NEEDS, THE CENTRAL BANK HAS ISSUED NEW RULES FOR MONEY MARKET OPERATIONS. BY MAKING SHORT-TERM PLACEMENTS LESS ATTRACTIVE, IT IS HOPED TO SHIFT RESOURCES TO LONGER TERM DEPOSITS AND DEPOSIT SUBSTITUTES. COMMERCIAL BANKS STAND TO BENEFIT, AT SOME COST TO NON-BANK FINANCIAL INSTITUTIONS, WHICH HAVE STRONGLY OPPOSED THE REGULATIONS. PROSPECTS FOR REORIENTING THE MONEY AND CAPITAL MARKETS ARE POSITIVE, BUT CERTAIN ATTRACTIONS OF SHORT-TERM MONEY REMAIN, AND THE FULL EFFECT OF THE NEW RULES IS DIFFICULT TO GUAGE AT THIS EARLY STAGE. END SUMMARY.

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1. CULMINATING MORE THAN TWO WEEKS OF INTENSIVE EXAMI-

NATION WITHIN THE MONETARY BOARD, THE CENTRAL BANK ISSUED A SERIES OF SEVEN CIRCULARS ON JANUARY 2, WITH THE OBJECTIVE OF REDIRECTING BANKS AND OTHER FINANCIAL INSTITUTIONS TOWARD LONGER-TERM SAVING AND LENDING OPERATIONS.

2. THE NEW REGULATIONS PROVIDE FOR MAXIMUM INTEREST RATES ON COMMERCIAL BANK TIME DEPOSITS ON A SCHEDULE RANGING FROM 8 1/2 PERCENT FOR 90 DAYS TO 12 PERCENT FOR 730 DAYS. MAXIMUM INTEREST RATES ON TIME DEPOSITS AT THRIFT BANKS AND RURAL BANKS ARE SET ONE-HALF PERCENT HIGHER. THERE IS NO CEILING ON RATES FOR DEPOSITS OVER 730 DAYS. MAXIMUM RATES ON SIMPLE SAVINGS DEPOSITS (AS OPPOSED TO TIME DEPOSITS) ARE SET AT 7 PERCENT IN COMMERCIAL BANKS AND 7 1/2 PERCENT IN THRIFT AND RURAL BANKS. THESE RATES AMOUNT TO INCREASES OVER PREVIOUSLY ALLOWABLE RATES OF ONE-HALF TO ONE PERCENT.

3. TIME DEPOSITS AND DEPOSIT SUBSTITUTES (INCLUDING CENTRAL BANK CERTIFICATES OF INDEBTEDNESS, GOVERNMENT SECURITIES, AND BANKERS ACCEPTANCES) WITH MATURITIES OVER 730 DAYS ARE EXEMPTED FROM THE INTEREST RATE CEILINGS PRESCRIBED BY THE USURY LAW. ON RECEIVABLES WITH MATURITIES OF 730 DAYS OR LESS, INSTITUTIONS MAY CHARGE UP TO 17 PERCENT, WITH NO CEILING ON RECEIVABLES OVER 730 DAYS. FOR LOANS OF MORE THAN 730 DAYS, A NEW MAXIMUM RATE OF INTEREST OF 19 PERCENT WILL APPLY, WHILE THE EXISTING LIMITS FOR LOANS OF LESS THAN 730 DAYS WILL CONTINUE TO APPLY -- 12 PERCENT FOR SECURED LOANS AND 14 PERCENT FOR UNSECURED LOANS.

4. MINIMUM SIZES AND MATURITY PERIODS OF DEPOSIT SUBSTITUTE TRANSACTIONS ARE ALSO FIXED. EFFECTIVE APRIL 1, MINIMUM SIZE OF PLACEMENTS FOR 730 DAYS OR MORE WILL BE 50,000 PESOS AND FOR LESS THAN 730 DAYS 100,000 PESOS; MINIMUM PLACEMENT OVER 730 DAYS WILL BE 100,000 PESOS AND LESS THAN 730 DAYS, 200,000 PESOS; MINIMUM MATURITY WILL BE 15 DAYS. INTERBANK CALL LOANS ARE EXEMPTED FROM THESE LIMITATIONS.

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5. FINALLY, RESERVE REQUIREMENTS FOR DEPOSITS AND DEPOSIT SUBSTITUTES ARE TO BE RAISED BY STAGES BRINGING APRIL 1, FROM THE PRESENT 5 PERCENT TO A FINAL LEVEL OF 20 PERCENT. DEPOSIT SUBSTITUTES AND TIME DEPOSITS WITH REMAINING MATURITIES OF TWO YEARS OR MORE ARE TO BE EXEMPTED FROM THE RESERVE REQUIREMENTS.

6. THE MATTER OF A TAX ON MONEY MARKET TRANSACTIONS

HAS BEEN REFERRED TO THE DEPARTMENT OF FINANCE FOR DRAFTING OF THE NECESSARY LEGISLATION. IN LATE NOVEMBER, PRES. MARCOS ISSUED A LETTER OF INSTRUCTION DIRECTING IMPOSITION OF SUCH A TAX, NOTING THAT IT WAS HOPED THEREBY TO MAKE MONEY MARKET TRANSACTIONS LESS ATTRACTIVE AND TO STIMULATE AVAILABILITY OF INVESTMENT FUNDS FOR INDUSTRIAL AND AGRICULTURAL PROJECTS. WE ARE TOLD THAT THE IMPLEMENTING REGULATIONS ARE DRAFTED, WITH ONLY THE TAX RATES LEFT BLANK.

7. COMMENT: FINANCE SECRETARY CESAR VIRATA HAS TAKEN THE LEAD IN PUSHING THESE FINANCIAL REFORMS THROUGH THE MONETARY BOARD AND IN LINING UP THE NECESSARY SUPPORT FROM MALACANANG. HE AND OTHERS HAVE LONG RECOGNIZED THAT THE COMBINATION OF A RATHER HIGHLY DEVELOPED MONEY MARKET AND A POORLY-DEVELOPED LONG-TERM CAPITAL MARKET IS ANOMALOUS AND DOES NOT SUPPORT DOMESTIC INVESTMENT LEVELS NECESSARY TO SUSTAIN DEVELOPMENT. THESE NEW MEASURES ARE PART OF AN ATTEMPT TO RESTRUCTURE INTEREST

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RATES TO MAKE SHORT-TERM TRANSACTIONS LESS ATTRACTIVE AND TO SHIFT RESOURCES TO GENUINE INVESTMENT USES.

8. VIRATA AND THE MONETARY BOARD KNEW THAT THEY WOULD BE STEPPING ON TOES IN THIS PROCESS, BUT STRENGTHENED BY A RECENT WORLD BANK (EFC) STUDY ON THE SUBJECT, CRANKED UP THE RESOLVE TO MOVE NOW. VIRATA TOOK PAINS TO EXPLAIN THE OBJECTIVES AND RATIONALE OF THE PROPOSED CHANGES BOTH PUBLICLY AND PRIVATELY DURING THE MONTH OF DECEMBER, AND THE BOARD WISELY OBTAINED THE PARTICIPATION OF THE BANKING AND FINANCIAL ASSOCIATIONS IN ITS DELIBERATIONS. THERE WAS APPARENTLY SIGNIFICANT COMPROMISE BEFORE THE FINAL SHAPE OF THE REGULATIONS WAS FIXED. THIS TACTIC WAS PARTIALLY SUCCESSFUL, AS THE BANKERS ASSOCIATION OF THE PHILIPPINES BACKED AWAY FROM JOINING A UNITED FRONT AGAINST THE PROPOSALS AND EVENTUALLY ENDORSED THE PACKAGE. NOT SURPRISINGLY, THE INVESTMENT HOUSES ASSOCIATION OF THE PHILIPPINES, LIMITED OFFICIAL USE

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REPRESENTING NON-BANK FINANCIAL INSTITUTIONS, HAS REGISTERED STRONG OBJECTIONS TO THE MEASURES, REFERRING TO THE MINIMUM MATURITY LIMIT OF 15 DAYS AS THE MOST QUOTE SERIOUS UNQUOTE OF THE NEW REQUIREMENTS, SINCE THIS WOULD REMOVE FROM NON-BANKS (WHICH CANNOT PARTICIPATE IN THE INTERBANK MARKET) THEIR ONLY LIQUIDITY MECHANISM FOR ADJUSTING DAILY MONEY POSITIONS.

9. ONE POSSIBILITY IS THAT THE NEW MEASURES WILL MAKE THE FREQUENTLY TIGHT SHORT-TERM MONEY MARKET EVEN TIGHTER. THE DIRECT CORRELATION BETWEEN BALANCE OF TRADE DEFICITS AND DOMESTIC LIQUIDITY SHORTAGES HAS BEEN ESPECIALLY NOTICEABLE THROUGH THE SECOND PART OF 1975, AND COULD BECOME ACUTE IN EARLY 1976 AS PAYMENTS FOR NORMALLY HEAVY YEAR-END IMPORTS FALL DUE. SHORT-TERM INTEREST RATES IN THE LATTER PART OF 1975 HAVE AVERAGED ABOUT 20 PERCENT, AND HAVE RANGED ABOVE 40 PERCENT FOR OVERNIGHT MONEY. WITHDRAWAL OF DISCRETIONARY FUNDS FROM THE SHORT-TERM MARKET COULD SEND RATES CLIMBING AGAIN. IN THE FIRST SESSION OF THE MONEY MARKET IN THE NEW YEAR, THERE WAS NO PERCEPTIBLE REACTION TO THE NEW RULES, AND THE OVERNIGHT RATES WERE BETWEEN 11 AND 17 PERCENT. THERE IS SOME BELIEF THAT THE CENTRAL BANK IS IN FACT PREPARED TO EASE SHORT-TERM LIQUIDITY NEEDS IF THEY ARISE.

10. OVER THE LONGER-TERM, THE NEW RULES COULD ENCOURAGE THE DESIRED SHIFT FROM MONEY MARKET PLACEMENTS TO SAVINGS AND TIME DEPOSITS AND GOVERNMENT SECURITIES.

WITH THE NEW MINIMUM TRANSACTIONS RULES, SMALLER INVESTORS WILL BE STRONGLY INCLINED TO MOVE FROM THE MONEY MARKET TO TIME DEPOSITS -- TO THE BENEFIT OF COMMERCIAL BANKS AND AT THE EXPENSE OF NON-BANK INTERMEDIARIES. THE LOCAL STOCK MARKET MAY BE AN INCIDENTAL BENEFICIARY OF ANY MOVEMENT OF FUNDS AWAY FROM SHORT-TERM MONEY. THE PRESS HAS ALSO SPECULATED THAT INVESTIBLE FUNDS MAY BE DIVERTED TO REAL ESTATE AND PURCHASE OF VALUABLES. THE LIMITATIONS ON MINIMUM PLACEMENT COULD HAVE THE EFFECT OF CREATING AN EXTRA-LEGAL MARKET FOR SHORT-TERM MONEY. THE EFFECTS OF THE NEW RULES WILL BE WATCHED CLOSELY, AND WE CAN EXPECT SOME PULLING AND HAULING AS THE FULL LIMITED OFFICIAL USE

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EFFECT COMES TO BE FELT DURING THE FIRST HALF OF 1976.

11. THIS ATTEMPT AT FINANCIAL REFORM MUST BE APPLAUDED. FAR TOO MUCH OF PHILIPPINE MONETARY AND HUMAN RESOURCES HAVE BEEN DEVOTED TO THE SHORT-TERM MARKET, TO THE DETERIMENT OF REAL DEVELOPMENT NEEDS. A COMBINATION OF TECHNICAL EXPERTISE AND POLITICAL WILL PRESENTS A REASONABLE PRESPECT OF SUCCESS IN REORIENTING THIS BIAS, BUT OLD HABITS DIE HARD. A RELUCTANCE TO MAKE LONG-TERM COMMITMENTS WILL PROBABLY PERSIST AMONG INVESTORS, AND THE ATTRACTIONS OF THE SHORT-TERM MARKET HAVE BY NO MEANS BEEN ENTIRELY NEUTRALIZED. THE FULL EFFECT OF THE NEW RULES MAY EMERGE ONLY GRADUALLY. END COMMENT.

12. COPIES OF THE CENTRAL BANK CIRCULARS ARE BEING POUCHED TO EA/PHL.
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